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DOW THEORY LETTERS

"THE MARKET AS INTERPRETED UNDER THE DOW THEORY"

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"WHY" and "HOW". The Dow Theory is completely and utterly a technical approach to the market. It is a study of the movements within the market itself, deriving nothing at all from business statistics, figures, economic reports or indexes of production. The Theory is based on empirical evidence. It says that this has happened over and over in the past, it will probably happen again now. We do not ask "why," when rails penetrate a previous high and industrials confirm, a general market advance follows; we know, through our studies of sixty-two years of the charted movements of the averages, that an advance (in all probability) will take place. We believe the probabilities are so good that we will back our belief with cash. We will buy stock on the advent of a bullish formation in the averages, regardless of the favorable or unfavorable current outlook as observed in the newspapers.

John Magee in his fine book "The General Semantics of Wall Street" explains that "why" is one of the most useless questions asked on Wall Street. Why is Westinghouse advancing? Why are the oils lagging? Why is the entire market rallying? None of these questions or their answers will help us to solve our basic problem, which is--making money in the stock market. The "why" question is doubly ridiculous because in the vast majority of cases, even after many months of intensive study have elapsed, we will still not have all the answers to any of the above questions. The reason for a move, said Hamilton, is seldom known in advance. He might have added that it is rarely known soon after.

The really important question to the technician is--"how." How will the rails act when they confirm an industrial high? How will Avco do when it breaks through its overhanging supply of stock? How will the market act near the top of the third phase? These are the questions which help us in our technical approach. It is a cold and impersonal approach; it is a study of charts and formations and past performance. But in the main it works and works well. Therefore we accept it. In this discussion I am not implying that fundamental analysis is not valuable or important. I am making the point that we do not need it for our purposes or goals.

Yet this argument seems to go against the emotions of most people. The "why" still bothers them. And they will not study the history necessary to allow them to believe the technical method. In the final analysis, it seems that the public, rather than face the cold facts of the laws of market-movements, prefers to trust their emotions and take their losses.

BUY-SPOTS. New students of the Dow Theory should practice the art of picking buy-spots. There is a widespread misconception that the Dow Theory implies buying only after both averages have bettered previous highs, and after bullish signals have been given. Nothing could be further from the truth. Hamilton and Rhea repeatedly outlined the following formation as a buying area. Following a normal decline or reaction, an advance will take place. After this advance, if on the next decline one or both averages hold above their previous lows and volume dininishes as the lows are approached, stocks should be purchased. The absence of volume on the second decline denotes a lack of selling pressure, and is almost always a bullish indication. Then after making our purchases, if the two averages advance over their old highs this merely corroborates our earlier bullish inferences, and points out that we were correct in buying near the lows. If, for some reason, we were mistaken and both lows are violated after we have bought stocks, we can sell and pay the price of "insurance" with but slight losses. Most buy-spots work out well, however, and they should be watched for on each decline.

DOW THEORY. Students of the price movements are fixing their eyes on the two points B and C (B-industrials 567.44, rails 157.91: C-industrials 540.72, rails 150.19). A joint violation of the C points by both averages would forecast lower prices and undoubtedly a halt in the economic upturn. An advance by both averages over point B would signal generally higher prices to come (probably a sharp advance to the 590-600 area), and a prediction of continued business expansion into at least the first quarter of next year. While the market pundits are airing their views for the coming season, the Dow-Jones Averages are evaluating the trend of future events coldly and unemotionally. It is the verdict of the averages that we Dow Theorists await.

Volume indications lead me to believe that the coming move will be upward. Last Friday as industrials eased 80¢ and rails 60¢, volume decreased to its lowest ebb since early September. Taking this as a buy-spot, this writer added securities to his line. If the present formation in the averages is a prelude to a downturn, it is a very deceptive one. Any activity or flurries of volume seem to be on the buy side. It is also significant that many investment-grade stocks such as General Electric, Westinghouse, American Telephone, and Owens-Illinois Glass are going to highs for the year or all-time highs in this area.

Significant also is the timing of the move since the panic lows of C. The climb back has been hesitant and plodding, compared to the explosive B-C sell-off. This, as we have discussed before, is action typical of a bull market. I feel that by the end of this year we may well be seeing a very bullish advance as the shorts run for cover and investment interests rush in to complete their portfolios. It is interesting from the technical standpoint to note that cash balances in banks, brokerage accounts, and savings and loan institutions are still huge. This could set the stage for a large-scale public entrance into this market during the first quarter of next year.

All of this, of course, depends upon a final penetration of both averages through their highs at B. Remember that it is not necessary for this penetration of both indicators to occur simultaneously. If industrials, for instance, hurdle their B point on bullishly increasing volume and rails are moving "in-gear" or in the same direction we may infer that the rails will confirm in due time. Past performance has proved this inference a valid one. (Dec. 17, 9A.M.)

The following stocks are in good technical patterns and may be bought: FRAUHAUF TRAILER, GENERAL RAILWAY SIGNAL, OWENS-ILLINOIS GLASS, NEW YORK CENTRAL, READING CO., AMERICAN TELEPHONE, EL PASO NATURAL GAS, CARPENTER STEEL, U.S. STEEL, SAFEWAY STORES, GIMBELS, TEXAS CO., MOLYDENUM.

Low-priced speculations: GENERAL INSTRUMENT, ELECTRICAL & MUSICAL INDUSTRIES, SPARTON, AVCO, CONTINENTAL MOTORS, ALLEGHANY CORP., DIVCO-WAYNE.

Today's A.T. & T. split sent industrials to 569.38, putting them through point B. To make things difficult rails diverged, dropping to 154.03. If volume now decreases on a decline or if rails and industrials advance together on increasing volume, the picture will be a bullish one. Naturally, if both averages turn down on increasing volume, the picture will be less pleasant. (Written Dec. 18, 8 A.M.)